

DRAFT**PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA****Telecommunications Division
Market Structure Branch****RESOLUTION T-16714
December 17, 2002****RESOLUTION**

RESOLUTION T-16714. VERIZON CALIFORNIA INCORPORATED (U-1002-C). REQUEST FOR APPROVAL OF PRICE CAP MECHANISM, IN COMPLIANCE WITH DECISION 89-10-031 AND DECISION 94-09-065, AND CORRESPONDING ADJUSTMENTS TO SURCHARGES WHICH WILL BE EFFECTIVE ON JANUARY 1, 2003.

BY ADVICE LETTER NO. 10227 FILED ON OCTOBER 1, 2002.

Summary

This Resolution authorizes Verizon California, Inc. (Verizon) to decrease its annual revenue by \$12,076,000 effective January 1, 2003. The adopted revenue adjustments and surcharge changes are shown in Appendices A and B attached to this resolution.

Verizon requested an annual revenue decrease of \$12,076,000 due to the impacts of a one-time limited exogenous (LE) factor adjustment for Local Competition Implementation Cost Recovery, a compliance adjustment for the NRF Audit Expense Recovery and a compliance adjustment for the GTEC/Bell Atlantic Merger Revenue Reduction. Because of the larger revenue decreases reflected in last year's price cap resolution, the effect of Verizon's proposal will lead to smaller surcredits in 2003 than in bills in 2002.

Background

In Decision (D.) 89-10-031 the Commission adopted an incentive-based regulatory framework (called the new regulatory framework or "NRF") for SBC Pacific Bell Telephone Company (Pacific) and GTE California Incorporated (GTEC), which is now known as Verizon California Incorporated. The decision stated that prices and rate caps would be indexed annually according to the Gross National Product Price Index (GNP-PI) inflation index reduced by a productivity adjustment.

The indexing formula allowed rate adjustments for a limited category of exogenous factors, called Z-factors, whose effects are not reflected in the GNP-PI. Only specific types of costs were considered Z-factors: changes in federal and state tax laws to the extent they affect the local exchange carriers disproportionately, mandated jurisdictional separations changes, and changes to intraLATA toll pooling arrangements or accounting procedures adopted by this Commission.

However, the Commission did not authorize Z-factor treatment for all unforeseen or exogenous factors. In D.89-10-031, the Commission stated that normal costs of doing business (including costs of complying with existing regulatory requirements) or general economic conditions would be excluded as Z-factor items.

In D.93-09-038, the Commission ordered GTEC to replace the GNP-PI with the Gross Domestic Product Price Index (GDP-PI), and in D.94-09-065, the Commission authorized Pacific and GTEC to implement the 1995 price cap rate adjustments through the billing surcharge/surcredit mechanism.

In 1995, the Commission issued D.95-12-052 regarding the second triennial New Regulatory Framework review and suspended the application of the GDP-PI minus productivity factor formula used in price cap regulation of Pacific and GTEC.

In October 1998, the Commission issued D.98-10-026 regarding the third triennial review of the NRF. The order continues the suspension of the GDP-PI minus productivity factor formula, suspends for the first time the sharing mechanism, permanently eliminates the depreciation review, replaces Z-factors with limited exogenous (LE) factors, and continues rate caps on residential services by keeping all rate caps and floors.

The order also specifies that, in the future, LE cost recovery is confined to recovery for cost increase or decreases resulting from (1) items mandated by the Commission and (2) changes in total intrastate recovery resulting from changes between federal and state jurisdiction. Recovery of Commission mandated cost changes must be authorized in the underlying Commission Decision.

Verizon's Price Cap Filing

On October 1, 2002 Verizon California Inc. filed Advice Letter No. 10227 requesting billing surcredit changes to be effective January 1, 2003 in order to implement the certain one-time revenue adjustments for 2003.

Verizon California Inc.'s filing requests the following revenue adjustments.

1. Local Competition Implementation Costs

Per D.01-09-063, Verizon California Inc. is authorized to recover its implementation costs for Local Competition of \$12.0 million over a 2-year period.

2. GTE-Bell Atlantic Merger Compliance Adjustment

Per D.00-03-021, the former GTE California Inc. which is now known as Verizon California Inc. must include an annual rate reduction of \$19.0 million per year for five years beginning with the first NRF price cap filing made after consummation of its merger with Bell Atlantic.

3. Recovery of NRF Financial Audit Expenses

Resolution T-16599 authorized Verizon to defer its request for recovery of NRF Financial Audit Expenses until the 2003 Price Cap. Now that the expenses are known and quantifiable, Verizon is asking to recover \$924,000 in NRF Financial Audit Expenses.

Verizon California requests a total revenue reduction of \$12.076 million to become effective on January 1, 2003, that reflects the local competition implementation costs ordered in D.01-09-063, the GTE-Bell Atlantic merger compliance adjustments ordered in D.00-03-021, and the NRF Financial Audit Expenses. Verizon used an annualized billing base of \$1,988,306,000 for calculating the surcredit effective January 1, 2003.

Notice/Protest

Verizon California Inc. stated that a copy of the advice letter, and related tariff sheets were mailed to all interested utilities and/or parties. Notice of Advice Letter No. 9888 was published in the Commission Daily Calendar on October 4, 2002.

ORA filed a timely protest on October 23, 2002 objecting to Verizon's treatment of the NRF Financial Audit Expenses as an LE factor since the audit costs do not qualify as having a major financial impact on Verizon's overall costs. ORA does not object to Verizon's recovery of its \$924,000 NRF audit expense as part of the price cap filing, only the LE factor treatment.

Response To Protest

Verizon responded to ORA's protest on October 30, 2002 claiming ORA failed to protest Verizon's intentions to seek recovery of NRF Audit Expenses during the previous three years, and the audit cost is large enough to qualify for LE factor treatment. Verizon also

states that the line item treatment of audit costs proposed by ORA would have the same financial impact as LE factor treatment.

Discussion

Local Competition Implementation Costs

In D.01-09-063 (OP 2), Verizon was authorized to include an implementation cost surcharge in its Annual Price Cap filing beginning January 1, 2002 to recover \$6 million per year for a two-year period, for a total of \$12 million, to be applied to exchange, toll, and access services pursuant to schedule CA. PUC No. 38-Billing Surcharges of Verizon's tariffs. The Telecommunications Division advises that Verizon's request for recovery of local competition implementation costs complies with D.01-09-063 and recommends adoption of the requested \$6 million .

GTE-Bell Atlantic Merger Compliance

In D.00-03-021 (OP 1.b), Verizon (formerly GTE California Inc.) was directed as follows.

"GTE California, or its successor, shall reduce its annual revenues by \$19.0 million per year for five years. GTE California, or its successor, shall include this revenue reduction in the first October 1 new regulatory framework price cap advice letter filing made after consummation of the merger. GTE California, or its successor, shall include this revenue adjustment in each October 1 price cap advice letter filing for a total of five years. Each price cap advice letter shall specify, among other things, the billing base for the purpose of this surcredit. The billing base shall include local, toll and access revenues, with the billing base incorporating the amount of both the CHCF-B and the annual total revenues from residential exchange service access charges. The billing base shall be updated with each price cap advice letter".

The Telecommunications Division advises that Verizon California Inc.'s price cap filing complies with Ordering Paragraph 1 in D.00-03-021, and recommends adoption of the \$19.0 million revenue reduction ordered in the decision. The filing also identified the billing base used for the merger surcredit for the 2002 price cap filing. The billing base includes local, toll and access revenues.

Recovery of NRF Financial Audit Fee

The issue of cost recovery related to the NRF audit was discussed in D.96-05-036. This decision did not guarantee recovery of audit related expenses, deferring such judgment until a request for recovery was submitted and given due consideration. Verizon, in its

2000 price cap filing, requested LE factor recovery for NRF financial audit expenses. In Resolution T-16376, this Commission determined that Verizon does have authorization for LE factor treatment of the NRF financial audit expenses under the current procedures, and declined to authorize recovery of costs associated with the NRF audit prior to incurrence of the costs. Verizon was allowed to seek recovery of costs associated with the NRF audit when actual costs are incurred. Verizon was also asked to include the nine-criteria Z-factor analysis with its request for recovery.

Since the proceeding addressing the NRF audit was completed, actual costs are known and the Commission on October 3, 2002 approved D.02-10-020. Verizon requests recovery of the approved expenses. Consistent with the findings in Resolution T-16376, Verizon is claiming the audit costs as an LE factor. Although ORA does not object to recovery of the audit costs in this price cap filing, ORA protests having Verizon recover such costs as an LE factor because they will not have a major financial impact as required for LE factor treatment.

After considering the ORA protest and Verizon's response on this matter, the TD recommends recovery of the instant audit costs as a revenue adjustment in this year's price cap filing. These costs should not be considered an LE factor in this circumstance and shall be treated as an other adjustment.

Impact of Adopted Changes

For the year 2002, Verizon was required to refund to customers \$19 million for adjustments from the GTE/Bell Atlantic Merger. The \$12.076 million revenue reduction adopted here is not large enough to offset the elimination of \$19 million last year. Accordingly, the surcredit on customer bills will be reduced as shown in Appendix B of this resolution. The effect of the reduced surcredit is that customers will pay slightly more (between 0.01% and 0.03%) for telephone service in 2003 than they paid in 2002.

311 Mailing of Draft Resolution

The draft resolution of the Telecommunications Division in this matter was mailed to parties in accordance with PU Code Section 311 (g). Verizon filed comments on December 2, 2002 stating that the price floor information was incomplete. After discussion with the Telecommunications Division staff, Verizon filed Supplement Advice Letter 10227A on December 6, 2002 to provide additional price floor information. Verizon requests confidential treatment of the price matrix and these attachments, and that all parties, other than ORA, must enter into a nondisclosure agreement to receive the information.

Findings

1. Verizon filed Advice Letter No. 10227 on October 1, 2002 to implement Verizon's 2003 price cap mechanism and certain revenue adjustments. Verizon requested adjustments for local implementation costs, the GTE-Bell Atlantic merger and the NRF financial audit fee.
2. The local competition implementation costs requested by Verizon in compliance with D.01-09-063 is reasonable and should be adopted.
3. The Bell-Atlantic merger savings refund identified by Verizon in compliance with D.00-03-021 is reasonable and should be adopted.
4. Verizon's request to recover the NRF Financial Audit Expenses as a one-time revenue adjustment is reasonable and should be granted. However, in this circumstance it should not be treated as an LE-factor adjustment. It should be treated as an other adjustment.
5. A total price cap mechanism decrease \$12.076 million is reasonable and should be made effective January 1, 2003.

THEREFORE, IT IS ORDERED that:

1. Verizon California, Inc. shall reduce its annual revenue by \$12.076 million as a result of its 2003 annual Price Cap Adjustment filing in Advice Letter No. 10227.
2. Verizon California, Inc. shall implement billing surcredits reflecting the revenue decrease ordered in Paragraph 1, applied to a total billing base of \$1,988,306,000 for intraLATA access services, intraLATA exchange and private line services, and intraLATA toll services, to become effective on January 1, 2003, subject to review and approval by the Telecommunications Division.
3. The revisions to Verizon California, Inc's price floors filed in Advice Letter No. 10227 are adopted and shall be implemented on January 1, 2003.

This Resolution is effective today.

I hereby certify that the Public Utilities Commission adopted this Resolution at its regular meeting on December 17, 2002. The following Commissioners approved it:

WESLEY M. FRANKLIN
Executive Director

APPENDIX A
Resolution T-16714

Verizon California, Inc.
2003 Price Cap Filing
\$ (in Millions)

	Verizon Proposed Revenue Impacts	Adopted Impacts
Ongoing Adjustments		
GTE-Bell Atlantic Merger Compliance	\$ (19.0)	\$ (19.0)
Local Competition Recovery Costs	\$ 6.0	\$ 6.0
One-Time Adjustments		
NRF Audit Fee	\$ 0.924	\$ 0.924
Total	\$ (12.076)	\$ (12.076)

APPENDIX B
Resolution T-16714

Verizon California, Inc.
2003 Price Cap Filing
(Adjustments by %)

	Verizon Existing Surcredit	Verizon Proposed Surcredit	Adopted Surcredit
Access	(3.71%)	(3.70%)	(3.70%)
Local	(0.72%)	(0.71%)	(0.71%)
Toll	(2.92%)	(2.89%)	(2.89%)